

APPENDIX F: FINANCIAL STATUS OF LARGEST LICENSEES: A 22 REVIEW SAMPLE BASED ON QUALIFICATION REVIEW FINANCIAL DATA

PURPOSE: The purpose of analyzing these financial data was to determine, within the information provided by a sample (22 reviews for 19 organizations) of the larger licensees:

- the size of the gambling portion of the organization relative to the program portion (gambling revenue and expenses are a significant portion of the total organization, often more than 50%);
- the relative reliance of the total organization on gambling revenues (most licensees are moderately to very reliant on gambling revenues);
- the financial health of the total organization compared to the gambling operation (overall financial health is not good for the periods reviewed).

The current Qualification Review process is neither required nor designed to review these types of indicators. The Qual Review worksheets were used in this analysis because they contain the types of financial data needed for this type of review. The data reviewed were provided by the licensees in their annual financial reports. Some of the organizations provided audited figures; all were required to have a licensed accountant prepare the figures, albeit from the organization's books. The Commission does not require that the actual audit document be submitted.

OVERALL CONCLUSIONS.

The data very strongly suggest that the Commission should set standards for how much of an organization's total (gambling and non-gambling) expense budget is gambling expense as one way to measure whether the organization exists for its stated purpose or primarily to provide gambling activities.

The data further suggest that, given the ongoing decline in the C/NP gambling sector generally, a number of licensees need to diversify their non-gambling funding sources to become less dependent on gambling net income.

The data strongly suggest that the Commission should monitor the overall financial health of licensees who are seeing large net losses in their total (gambling and non-gambling) operations.

Organizations which have a relatively small percentage (less than 30%) of gambling revenue and expenses compared to their total operation (gambling and non-gambling) generally were not doing well financially overall for the period reviewed (2002-03). This suggests that their gambling net income has dropped but has not been replaced quickly enough by other revenue sources.

For the handful of cases where licensees were earning high levels of total net income (gambling and non-gambling) which were far in excess of the funds needed to operate non-gambling activities, the Commission should conduct a thorough review under the excess reserves policy in WAC 230-02-137.

FINDINGS:

Extent of the gambling operation as a percentage of the total (gambling and non-gambling) operation. Twelve (54.5%) of the 22 reviews show organizations with 60% or more of their total EXPENSES in their gambling operation. Four (18%) had more than 80% of their EXPENSES in their gambling operation.

Many of the organizations reviewed here were operating their charitable or nonprofit purposes as part of their program organizations—in other words, the reported information was for both gambling and non-gambling operations. Thus, the high percentage of total expenses attributable to the gambling operation is of concern.

At least two of the organizations may be relatively new to C/NP gambling and building their capacity before making significant commitments to expanding programs. Thus, they may have a larger percentage of expenses in the gambling portion of the operation. However, many of the others are long-term licensees and this explanation does not apply.

There does not appear to be a relationship between the percent of total operation (gambling and non-gambling) expenses that are gambling expenses and other financial issues. No patterns emerged related to net losses or CTR.

This indicator raises the question of the purpose of the organization. What percentage of total expenses is acceptable to document that the primary purpose of the organization is the charitable or nonprofit purpose, rather than gambling?

Ohio answers this question by requiring that no more than 50% of total expenses be attributable to the gambling operation. Under Ohio's requirement, seventeen (77.2%) of the situations reviewed would be out of compliance.

Reliance on gambling revenue. Of the 22 situations reviewed, nine (41%) had 60% or more of their total organizational REVENUE (gambling and non-gambling) coming from the gambling operation. Two report more than 100% of their REVENUE coming from their gambling operation because they had negative revenue (primarily losses in investment accounts) in the program portion of their organization.

This extensive reliance on gambling revenue as a major portion of total revenue indicates that the organizations are not diversifying their funding bases. This in turn makes their charitable and nonprofit programs vulnerable to downturns in gambling activity and income. Given the generally downward trend in C/NP gambling, all licensees should be working to diversify their funding bases if they want to continue their C/NP services and activities at current levels.

This indicator again raises the question of the purpose of the organization. What percentage of total revenue (gambling and non-gambling) should be gambling-generated? At what point is the percentage high enough to suggest that the organization's purpose really is gambling and not charitable or nonprofit purposes?

This indicator also relates to a typical C/NP standard, that no single source of revenue should be more than one-third of an organization's total revenue.

Overall Financial Health. Of the 22 worksheets reviewed (representing 19 organizations because three were reviewed twice), 15 (or 68%) showed an overall net loss for the total organization for the period being reported. This means that when revenue and expenses for gambling and non-gambling operations were added together, the total organization had less overall revenue than expenses for the period being reviewed. Some of the losses were significant.

The reported losses for the total operation (gambling and non-gambling) ranged from \$613,096 to \$1,914. The average net loss was \$150,641. Five organizations had net losses of \$100,000 or more; another four had net losses of \$50,000 to \$99,000. Losses of this magnitude, even for only one year, can endanger the ability of the organization to continue as a going concern.

Two of the three organizations which have two reviews in this analysis lost money in their total operations (gambling and non-gambling) in both periods.

Given that all 22 worksheets reported positive net income in the gambling portion of their operation, this means that 68% of these licensees were, in the period reported, not able to run their program services portion of their organization profitably.

While there may have been extenuating circumstances for some licensees, it is unlikely that all 15 had extenuating circumstances causing losses of this magnitude.

The question these data raise is: whether these organizations are capable of running profitable gambling operations but are not capable of running profitable program services operations. Therefore, is their primary purpose (in terms of their financial results) gambling or programs?

These data also raise the question of whether some of these organizations are weak enough financially to be in danger of dropping their program services or of closing entirely. If so, are players who participate in these organizations' gambling activities for the intent of benefiting the charitable or non-profit purpose being misled?

If it is possible that the figures being reported are not accurate, then requiring CPA-audited financial statements is necessary.

The 30/30 club. Only two of the 22 situations reviewed had both gambling revenues and expenses that were 30% or less of total revenues or expenses (gambling and non-gambling).

Both of these organizations had significant net losses for the period reported. This suggests either that their gambling operation was not large enough to

generate significant income or that their gambling income has been dropping and other sources of revenue have not yet replaced it.

There were seven organizations that had 30% or lower expenses **or** revenues (but not both). All but one of the seven organizations that generated less than 30% of their revenue from gambling lost money in their total organization (gambling and non-gambling); four lost more than \$60,000 and two lost more than \$250,000. However the net income from gambling was large enough (ranging from a maximum of \$291,716 to a minimum of \$38,829 for these seven groups) that it would be challenging to replace it, given the losses in the non-gambling area.

In either case, the numbers suggest it would be useful to monitor the trends of gambling net income for these organizations to determine how the role and size of the gambling operation is changing over time. Long term, these organizations cannot sustain the large net losses reflected in the figures reviewed and either need to sharply increase their income from gambling, reduce their gambling expenses, increase their income from non-gambling sources, or reduce their C/NP programs.

High total net income and its implications. There were five (22.7%) situations reviewed where the licensee reported over \$100,000 in total net income (gambling and non-gambling) for the period.

All five spent 50% or more of their total organizational expenses on gambling. Two were over 60%, one was over 70% and one was over 80% of total organizational expenses being attributable to gambling.

This means that one had less than 20% of its total organizational expenses in programs; one had less than 30% and two had less than 40%. Given this high level of net income, where were those dollars of income going?

It is possible that some of these organizations were saving money to invest either in gambling upgrades or program expansion. However, the amassing of significant amounts of unused cash, especially when gambling expenses are a large part of the total organization, should be tracked to assure that the gambling income does eventually end up supporting the charitable or nonprofit purpose. The excess reserves rule (230-02-137) provides a means to do this.

These five licensees vary in percent of total revenue attributable to gambling operations, from a low of 34% to a high of 85%. This suggests further study before an indicator can be developed.

**ORGANIZATIONS WHOSE QUALIFICATION REVIEW WORKSHEETS WERE
REVIEWED FOR THIS ANALYSIS**

<u>ORGANIZATION</u>	<u>DATE OF QUAL REVIEW</u>
LOOM #1774	4/1/02
Cascade Youth Music	9/30/02 (1)
Spokane Valley Foundation	6/30/02
Lions-N. Everett	6/30/02
Gateways for Youth&Families	12/31/02
Exchange Club/Tacoma	6/30/02 (1)
DV/ Sexual Assault Center	12/31/02
Columbia Center Rotary	6/30/02
Mid Columbia Coalition for Children	12/31/02
Northern Lights Drum&Bugle	12/31/02
Sister Rebecca Berghoff Fdn.	12/31/02
Sound Institute for Families&Children	6/30/02 (1)
Seattle Jaycees	12/31/02
Amvets #1	12/31/03
Cascade Youth Music	6/30/03 (2)
Exchange Club/Tacoma	6/30/03 (2)
Seattle Junior Hockey	6/30/03
Silver Buckle Rodeo	6/30/03
Sno-King Hockey	6/30/03
Sound Institute for Families&Children	6/30/03 (2)
Spokane FOE #002	5/31/03
Walla Walla Catholic School	6/30/03